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Akana K.J. Ma
akm@aterwynne.com
(503) 226-8489

Douglas D. Morris
ddm@aterwynne.com
(503) 226-8416

Thomas M. Karnes
tk@aterwynne.com
(503) 226-8654

SALES REPRESENTATIVE AND DISTRIBUTORSHIP CONTRACTS IN CALIFORNIA

By: Akana K.J. Ma, Douglas D. Morris and Thomas M. Karnes

California has a number of statutes and areas of case law that could raise issues with respect to sales representative and distributorship contracts. Similar to other jurisdictions in the United States, California's law of contracts is based on common law principles, which are in turn supplemented by statute.

Freedom of Contract

Portland

1331 NW Lovejoy Street
Suite 900
Portland OR 97209
www.aterwynne.com
Main Tel: (503) 226-1191
Main Fax: (503) 226-0079

California law generally provides that the terms negotiated by the parties to an agreement should be enforced. One notable exception, however, is the California Independent Wholesale Sales Representative Contractual Relations Act of 1990 described below.

Seattle

601 Union Street
Suite 1501
Seattle WA 98101
www.aterwynne.com
Main Tel: (206) 623-4711
Main Fax: (206) 467-8406

California courts align with the objective view of contract interpretation and construction. Under the objective view, courts interpret and construe contracts to give effect to the outward manifestation of the parties' intent. That emphasis on the parties' expressed intent is especially pronounced with respect to written contracts, in which case courts are to ascertain the parties' intent from the writing alone.

Menlo Park

3723 Haven Avenue
Suite 126
Menlo Park CA 94025
www.aterwynne.com
Main Tel: (650) 566-1443
Main Fax: (650) 325-2340

California case law reveals one noteworthy caveat to the general view that a written contract is the best representation of the parties' intent. Specifically, in a handful of limited contexts, California courts will consider extrinsic evidence. For instance, California courts interpreting contracts for the sale of goods, which may include many distributorship agreements, will likely supplement the written words of a contract with extrinsic evidence pertaining to course of dealing and usage of trade. Additionally, if a contract provision is ambiguous or uncertain, California courts may consider such extrinsic evidence as testimony regarding the purported purpose for the agreement and the parties' conduct after entering into the agreement.

Salt Lake City

341 S Main Street
Suite 309
Salt Lake City UT 84111
www.aterwynne.com
Main Tel: (801) 532-2721
Main Fax: (503) 226-0079

California Independent Wholesale Sales Representative Contractual Relations Act of 1990

Although California generally allows parties to draft the terms of their contractual relationship as the parties deem appropriate, the California Independent Wholesale Sales Representatives Contractual Relations Act of 1990 imposes a number of non-waivable requirements on certain contracts between manufacturers and sales representatives. The California Act will apply whenever: (i) a manufacturer is engaged in business within California; (ii) the manufacturer uses an independent wholesale sales representative to solicit wholesale orders at least partially within California; and (iii) the contemplated method of payment involves commissions. The wholesale sales representative must also not sell or take orders for the direct sale of products to the ultimate consumer. The California Independent Wholesale Sales Representatives Contractual Relations Act of 1990 can also apply to agreements between distributors and wholesale sales representatives.

If the above conditions are satisfied, the Act imposes two requirements on manufacturers that enter into such agreements with wholesale sales representatives. First, manufacturers and wholesale sales representatives must enter into a written contract. That written contract must specify:

- (i) The rate and method by which the commission is computed;
- (ii) The time when the commission will be paid;
- (iii) The territory assigned to the wholesale sales representative;
- (iv) All exceptions to the assigned territory and customers therein; and
- (v) What chargebacks will be made against the commissions, if any.

The Act defines “chargebacks” as any “deduction taken against the commissions earned by the sales representative which are not required by state or federal law.” Second, with each commission payment the manufacturer must include certain written information regarding the order associated with the commission, the rate of commission, and the nature of any chargebacks.

In addition to the above two requirements, the Act also provides that any manufacturer that is not otherwise a resident of California and that enters into an agreement subject to the Act is deemed to be doing business in California for purposes of California courts exercising jurisdiction. Furthermore, any manufacturer that willfully fails to enter into a written contract or willfully fails to pay commissions as required by the Act is liable to the sales representative for three (3) times the damages proved in a civil proceeding related to that arrangement. Finally, the prevailing party in a civil proceeding arising out of that arrangement is entitled to reasonable attorney fees and costs in addition to any other recovery.

It is worth noting that, apart from the Independent Wholesale Sales Representatives Contractual Relations Act of 1990, California has a related statute that imposes various requirements on companies that pay their employees on commission and that lack a permanent or fixed place of business in California. That statute could conceivably capture some arrangements among

manufacturers, distributors, and sales representatives. However, federal courts in California have held that the statute is unconstitutional as a restraint on interstate commerce in violation of the Commerce Clause of the United States Constitution.

The Independent Wholesale Sales Representatives Contractual Relations Act of 1990 applies to agreements involving wholesale sales representatives, not to agreements between manufacturers and distributors. Nonetheless, other California statutes regulate certain types of distributorship agreements. For example, California statutes impose a number of requirements on arrangements between manufacturers and distributors of spirits, wine, and beer products.

Unlike certain jurisdictions outside the U.S., California does not impose any compensation payment requirements solely arising due to the termination of a sales representative or distributor.

Other Issues

California law touches upon various other issues that are likely to arise in a typical sales representative or distributorship arrangement. First, sales representative and distributorship agreements commonly include noncompetition provisions. However, a California statute provides that “every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.” Although the above statute and the related case law point to some limited exceptions to that general standard, such as the sale of a business, those exceptions are unlikely to apply to the typical sales representative or distributorship agreement. Manufacturers should therefore not expect to include an enforceable noncompetition provision in California sales representative or distributorship contracts.

Second, arrangements among manufacturers, distributors, and sales representatives can, in certain instances, qualify as franchises or business opportunities under California law. California statutes define a “franchise” as an agreement by which:

- (i) A franchisee is granted the right to engage in a marketing system substantially prescribed by the franchisor;
- (ii) The business is substantially associated with the franchisor’s trademark or commercial symbol; and
- (iii) The franchisee is required to pay the franchisor a fee.

Being characterized as a franchise is noteworthy, because California’s franchise statutes require that franchisors satisfy two primary obligations, along with a variety of lesser requirements. First, franchisors must register with the California Department of Corporations prior to offering for sale any franchise interests. Second, franchisors must provide an offering circular to prospective franchisees that discloses certain information about the franchise. Penalties for failing to satisfy the above registration and disclosure requirements may include civil liability and other penalties.

In addition to the California franchise laws, manufacturers looking to enter into sales representative or distributorship arrangements should evaluate whether the proposed

arrangement constitutes a Seller Assisted Marketing Plan (SAMP), commonly referred to as “business opportunities,” under California’s Seller Assisted Marketing Plan Act. Stated broadly, a SAMP includes any advertised or solicited offer to sell, in exchange of an initial payment of more than \$500, any product or service that will aid a purchaser in conducting a business. The seller must also make various representations regarding the purchaser’s ability to earn a profit in the business, the market for the product, or the seller’s willingness to buy back any product purchased under the SAMP. If an arrangement qualifies as a SAMP, the seller of the SAMP must comply with a number of registration and disclosure requirements. Violators of California’s Seller Assisted Marketing Plan Act may incur a variety of civil liabilities.

Third, manufacturers should assess the possible state and local tax implications associated with entering into sales representative and distributorship arrangements in California. Along with a number of county and city taxes, California imposes two primary corporate taxes: the corporate franchise tax and the corporate income tax. California levies its franchise tax on the net income of every corporation doing business in the state. Stated generally, a corporation is “doing business” in California when it is actively engaging in any transaction for the purpose of pecuniary gain. By contrast, California’s corporate income tax applies to the net income of every corporation that derives income from California sources and that is not otherwise subject to the California corporate franchise tax. Corporations with income from inside and outside of California will apportion that income for purposes of ascertaining their California taxable income. That apportionment may occur within a single corporation or within a “unitary business” in the case of two or more corporations that share certain common attributes. California also offers a “water’s edge” election for the apportionment of income for certain foreign corporations doing business in the state. Along with California’s corporate level taxes, manufacturers should also evaluate whether their activities could trigger possible California sale and use tax obligations.

California generally taxes pass-through entities in a manner similar to the federal tax code. That being said, California’s tax statutes and regulations for pass-through entities contain various provisions that are analogous to California’s corporate tax regime. For example, limited liability companies are subject to an \$800 annual franchise tax, plus an additional annual “fee” based on the LLC’s total income.

Finally, sales representative and distributorship arrangements can raise a number of issues with respect to California’s antitrust laws. California courts generally treat the California antitrust laws as mirroring the federal antitrust regime. The most common antitrust issues presented by sales representative and distributorship arrangements include resale price maintenance (i.e., the seller and reseller agree that the reseller will charge a particular price for the goods on resale), territorial and customer restrictions, exclusive-dealing and requirement contracts, and tying arrangements.

The above issues can be complex, and conclusions with respect to those issues will vary significantly depending on the facts of each unique situation. Manufacturers that are interested in pursuing a sales representative or distributorship arrangement in California are advised to assess such issues with local counsel.

California Resources

- **California Tax Service Center:** <http://www.taxes.ca.gov/>. The California Tax Service Center is sponsored by the California Board of Equalization, the California Franchise Tax Board, and various other state and federal agencies related to taxation. The Center's website offers a comprehensive collection of publications discussing the various California state taxes.
- **California Department of Corporations:** <http://www.corp.ca.gov/>. The Securities Regulations Division (SRD) of the Department of Corporations is responsible for regulating the sale of franchises. The SRD website offers resources regarding franchise disclosure and registration.
- **California Office of the Attorney General:** <http://ag.ca.gov/index.php>. The California Office of the Attorney General (OAG) is responsible for registering business opportunities. The OAG's website for business opportunities, http://ag.ca.gov/consumers/general/business_opportunities.php, offers guidance as to registration procedures.
- **California Office of the Attorney General, Antitrust Section:** <http://www.ag.ca.gov/antitrust/>. The OAG's Antitrust Section is responsible for civil and criminal enforcement of California's antitrust laws. The OAG's website offers resources outlining California's antitrust laws, as well as the OAG's recent enforcement efforts.
- **California Secretary of State:** <http://www.sos.ca.gov/business/>. The California Secretary of State offers a "business portal" that collects resources describing the different government agencies with regulations pertaining to business. Those resources include copies of various forms and publications.